

OPEN MEETING



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ORIGINAL

MEMORANDUM

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Arizona Corporation Commission

DOCKETED

2010 MAY 11 A 10: 51

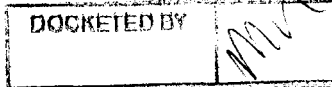
MAY 11 2010

AZ CORP COMMISSION
DOCKET CONTROL

TO: THE COMMISSION

FROM: Utilities Division

DATE: May 11, 2010



RE: ARIZONA PUBLIC SERVICE COMPANY - APPLICATION FOR AN ORDER APPROVING MODIFICATIONS IN INVESTMENT FUND CONTRIBUTION LIMITS AND ALLOWING ADDITIONAL TRUST FUND INVESTMENT FLEXIBILITY (DOCKET NO. E-01345A-10-0067)

On February 24, 2010, Arizona Public Service Company ("APS") filed with the Arizona Corporation Commission ("Commission") an application seeking approval of modifications in investment fund contribution limits and additional flexibility in the management of its Palo Verde Nuclear Generating Station decommissioning trust fund.

More specifically, APS cites in the application that it requests a Commission Order authorizing:

- 1) removal of the \$75 million funding contribution cap for each of the fixed-income Palo Verde Nuclear Generating Station decommissioning trust funds managed by Delaware Investment Advisors and NISA Investment Advisors;
- 2) removal of the \$200 million funding contribution cap for the equity trust fund managed by Mellon Capital Management; and
- 3) discretion to move funds between the above forms of equity and fixed-income investments subject to the overall 60/40 equity/fixed-income allocation strategy established in Decision No. 60098 (March 19, 1997).

APS estimates that it will reach the authorized contribution limits for both fixed-income funds by the third quarter of 2010. APS states that removing the contribution funding levels, as well as increasing the flexibility in transferring funds between managers will allow it a greater ability to manage fund risk under often rapidly changing market conditions.

Commission Decision No. 55931 (April 1988) ordered APS to establish an external nuclear decommissioning trust fund. The fund serves as an account for savings of money to be used for the eventual decommissioning of the Palo Verde Nuclear Generating Station. Currently, APS invests the decommissioning funds with three separate managers: Mellon Capital Management ("MCM"), Delaware Investment Advisors ("DIA"), and NISA Investment Advisors ("NISA"). The MCM fund is an equity fund that holds companies within the S&P 500.

THE COMMISSION

May 11, 2010

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The DIA fund is a fixed-income fund that includes U.S. Treasury and other government securities, corporate bonds, asset-backed securities, and municipal bonds. The NISA fund is also a fixed-income fund and is similar to the DIA fund.

In the application, APS reports that as of January 31, 2010, the contributions and market values of the funds are as follows:

Table I

	<u>Contributions</u>	<u>Market Value</u>
DIA fixed-income fund	\$73.7 million	\$117.7 million
NISA fixed-income fund	\$68.9 million	\$158.8 million
MCM equity fund	\$97.5 million	\$137.2 million
Total	\$240.1 million	\$413.7 million

Following Decision No. 55931, successive Commission orders have placed caps on the amount of investment that can be made in the trust funds. Most recently, Decision No. 64939 (January 2002) ordered a cap of \$75 million funding of the Company's fixed-income Palo Verde trust fund previously managed by RCM Capital Management, a cap of \$75 million funding of the fixed-income Palo Verde trust fund managed by DIA, and \$200 million funding in equity funds managed by MCM.

The caps have the effect of permitting APS to place additional monies in the funds only until the total of deposits made in the accounts reach the prescribed limits. Thereafter, APS cannot contribute additional amounts, but the funds can continue to accumulate earnings in excess of the caps.

Decision No. 60098 also established an investment strategy that set parameters for the ratio of both equity and fixed-income fund contributions as a percentage of total decommissioning funds. The ordering language is as follows: "It is further ordered that Arizona Public Service Company's request to apportion the Decommissioning Trust funding such that 40 percent of the assets would be invested in fixed income securities while 60 percent of the assets would be invested in equity securities in accordance with Findings of Fact No. 19 be and hereby is approved."

Staff finds that at this time caps on the amount up to which deposits can be made into a fund are no longer necessary. The caps would place APS in an awkward position should the funding caps be reached. In such a circumstance, APS would continue to collect decommissioning funds from ratepayers, but be prohibited from investing them in the decommissioning trust funds.

Any control the Commission might wish to maintain over the relative balance between investment in equity vs. fixed-income funds can be achieved through a subsequent Commission Order or Orders that deal specifically with the management of the balance of equity vs. fixed-income investment.

To date, the caps have served to ensure prescribed levels of diversification of investment between the three funds. Staff notes that diversification is traditionally good financial practice; however, caps on the funding could serve to constrain APS from making a prudent financial decision to shift money out of an underperforming or risky fund and into another fund in the decommissioning portfolio.

It would be difficult, if not impossible, to know with certainty what future events or market conditions might arise making a Commission ordered cap on investment in a given fund in the decommissioning portfolio a constraint that prevents the best management of the portfolio. Staff also finds that an updated guideline for management of the balance of equity compared to fixed-income investment could serve to establish greater clarity about the parameters of authorized management of the balance of the invested funds.

Traditionally, equity investments carry a greater risk than fixed-income investments. Equity investors expect greater returns as compensation for the additional risk associated with an equity investment when compared to a fixed-income investment. In the recent past, the stock market has experienced a great deal of volatility, particularly downward volatility. While no one can know the future of securities markets, a risk-averse management strategy for the decommissioning funds is likely to be prudent given the importance of nuclear decommissioning and need for the availability of funding for the nuclear decommissioning. As time passes and the date when decommissioning of the Palo Verde Nuclear Generating Station draws closer, a management strategy of the decommissioning funds that steadily reduces risk further will be progressively more prudent. As the decommissioning date draws close, a balance of funds within the decommissioning portfolio that minimizes equity funds in favor of less risky investments will likely be appropriate.

An order specifying that APS is authorized to move funds between the equity and fixed-income investments so long as the overall equity investment percentage of the investment portfolio does not exceed 60 percent will serve to both grant APS the flexibility to prudently manage the decommissioning funds as appropriate for the prevailing market conditions and adjust the balance between funds within the portfolio as the decommissioning date approaches. Such an order will also serve to provide greater clarity regarding the approved management of the decommissioning fund's balance of equity and fixed-income investment.

In addition to providing a periodic opportunity for the Commission to manage the fund levels of each of the three funds, the caps have served in the past as a mechanism that has brought the matter of the general management of the fund to the attention of the Commission periodically and prompted the issue at Open Meeting for the Commission to make adjustments to

the management of the funds whether the adjustments dealt with the fund levels or any other aspect of fund management.

Removal of the caps would provide APS with greater flexibility to manage the fund portfolio; however, it will eliminate the impetus for APS to periodically raise the issue for the Commission's consideration, as well as a convenient opportunity for the Commission to review the status of the portfolio and, should it choose to do so, issue any new orders to adjust the portfolio as deemed appropriate.

APS does file an annual Decommissioning Fund Performance Report with the Director of the Utilities Division pursuant to Decision No. 56047 (July 1988). The reports, however, do not involve an Open Meeting forum for Commission consideration as do applications for changes to the fund caps.

Staff recommends removal of the funding contribution caps for each of the Palo Verde Nuclear Generating Station decommissioning trust funds in order to provide flexibility that will enable APS to best manage fund risk in the decommissioning portfolio.

Staff further recommends authorization for APS to move funds between the equity and fixed-income investments so long as the overall equity investment percentage of the investment portfolio does not exceed 60 percent in order to provide flexibility that will enable APS to best manage fund risk in the decommissioning portfolio.

Staff further recommends that, every five years, APS make informational filings with the Commission through Docket Control. The informational filings shall be in a written format including the information contained in the annual Decommissioning Fund Performance Reports and also include descriptive discussion of the performance of the funds and other information APS deems would be helpful to the Commission in its oversight of the funds.

These informational filings shall be filed promptly following receipt of the annual fund performance reports APS receives from the trustee. These informational filings and the related Open Meeting presentations described below shall occur in five year increments and correspond with every subsequent fifth annual Decommissioning Fund Performance Report filed with the Utilities Division Director beginning in 2011.

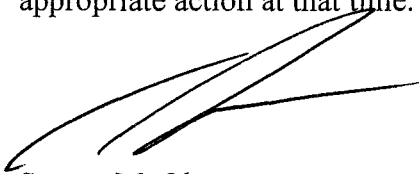
Following the filing of each fifth year filing containing the information described in the paragraph above, APS shall provide an oral presentation in Open Meeting relating to the written informational filing. Staff makes this recommendation to create the same Open

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May 11, 2010

Page 5

Meeting forum for Commission consideration as has previously been afforded by applications for changes to the fund caps. Staff notes that the Commission would be able to take any appropriate action at that time.

A handwritten signature in black ink, consisting of several fluid, overlapping strokes that form the name 'Steven M. Olea'.

Steven M. Olea
Director
Utilities Division

SMO:SPI:lhv\CH

ORIGINATOR: Steve Irvine

1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 KRISTIN K. MAYES

Chairman

3 GARY PIERCE

Commissioner

4 PAUL NEWMAN

Commissioner

5 SANDRA D. KENNEDY

Commissioner

6 BOB STUMP

Commissioner

7
8 IN THE MATTER OF THE APPLICATION)
OF ARIZONA PUBLIC SERVICE)
9 COMPANY FOR AN ORDER APPROVING)
10 MODIFICATIONS IN INVESTMENT FUND)
CONTRIBUTION LIMITS AND)
11 ALLOWING ADDITIONAL TRUST FUND)
INVESTMENT FLEXIBILITY)
12
13

DOCKET NO. E-01345A-10-0067

DECISION NO. _____

ORDER

14 Open Meeting
May 26 and 27, 2010
15 Phoenix, Arizona

16 BY THE COMMISSION:

17 FINDINGS OF FACT

18 1. Arizona Public Service Company ("APS") is certificated to provide electric service
19 as a public service corporation in the State of Arizona.

20 2. On February 24, 2010, APS filed with the Arizona Corporation Commission
21 ("Commission") an application seeking approval of modifications in investment fund contribution
22 limits and additional flexibility in the management of its Palo Verde Nuclear Generating Station
23 decommissioning trust fund.

24 3. More specifically, APS cites in the application that it requests a Commission Order
25 authorizing:

- 26 a) removal of the \$75 million funding contribution cap for each of the
27 fixed-income Palo Verde Nuclear Generating Station
28 decommissioning trust funds managed by Delaware Investment
Advisors and NISA Investment Advisors;

1 b) removal of the \$200 million funding contribution cap for the equity
2 trust fund managed by Mellon Capital Management; and

3 c) discretion to move funds between the above forms of equity and
4 fixed-income investments subject to the overall 60/40 equity/fixed-
5 income allocation strategy established in Decision No. 60098
(March 19, 1997).

6 4. APS estimates that it will reach the authorized contribution limits for both fixed-
7 income funds by the third quarter of 2010.

8 5. APS states that removing the contribution funding levels, as well as increasing the
9 flexibility in transferring funds between managers will allow it a greater ability to manage fund
10 risk under often rapidly changing market conditions.

11 6. Commission Decision No. 55931 (April 1988) ordered APS to establish an external
12 nuclear decommissioning trust fund. The fund serves as an account for savings of money to be
13 used for the eventual decommissioning of the Palo Verde Nuclear Generating Station.

14 7. Currently, APS invests the decommissioning funds with three separate managers:
15 Mellon Capital Management ("MCM"), Delaware Investment Advisors ("DIA"), and NISA
16 Investment Advisors ("NISA").

17 8. The MCM fund is an equity fund. It holds companies within the S&P 500.

18 9. The DIA fund is a fixed-income fund. The portfolio includes U.S. Treasury and
19 other government securities, corporate bonds, asset-backed securities, and municipal bonds.

20 10. The NISA fund is also a fixed-income fund and is similar to the DIA fund.

21 11. In the application, APS reports that as of January 31, 2010, the contributions and
22 market values of the funds are as follows:

23 Table I

	<u>Contributions</u>	<u>Market Value</u>
24 DIA fixed-income fund	\$73.7 million	\$117.7 million
25 NISA fixed-income fund	\$68.9 million	\$158.8 million
26 MCM equity fund	\$97.5 million	\$137.2 million
27 Total	\$240.1 million	\$413.7 million

28 ...

...

12. Following Decision No. 55931, successive Commission orders have placed caps on the amount of investment that can be made in the trust funds. Most recently, Decision No. 64939 (January 2002) ordered a cap of \$75 million funding of the Company's fixed-income Palo Verde trust fund previously managed by RCM Capital Management, a cap of \$75 million funding of the fixed-income Palo Verde trust fund managed by DIA, and \$200 million funding in equity funds managed by MCM.

13. The caps have the effect of permitting APS to place additional monies in the funds only until the total of deposits made in the accounts reach the prescribed limits. Thereafter, APS cannot contribute additional amounts, but the funds can continue to accumulate earnings in excess of the caps.

14. Decision No. 60098 also established an investment strategy that set parameters for the ratio of both equity and fixed-income fund contributions as a percentage of total decommissioning funds.

15. The ordering language is as follows: "It is further ordered that Arizona Public Service Company's request to apportion the Decommissioning Trust funding such that 40 percent of the assets would be invested in fixed income securities while 60 percent of the assets would be invested in equity securities in accordance with Findings of Fact No. 19 be and hereby is approved."

16. Staff finds that at this time caps on the amount up to which deposits can be made into a fund are no longer necessary. The caps would place APS in an awkward position should the funding caps be reached. In such a circumstance, APS would continue to collect decommissioning funds from ratepayers, but be prohibited from investing them in the decommissioning trust funds.

17. Any control the Commission might wish to maintain over the relative balance between investment in equity vs. fixed-income funds can be achieved through a subsequent Commission Order or Orders that deal specifically with the management of the balance of equity vs. fixed-income investment.

18. To date, the caps have served to ensure prescribed levels of diversification of investment between the three funds. Staff notes that diversification is traditionally good financial

1 practice; however, caps on the funding could serve to constrain APS from making a prudent
2 financial decision to shift money out of an underperforming or risky fund and into another fund in
3 the decommissioning portfolio.

4 19. It would be difficult, if not impossible, to know with certainty what future events or
5 market conditions might arise making a Commission ordered cap on investment in a given fund in
6 the decommissioning portfolio a constraint that prevents the best management of the portfolio.

7 20. Staff also finds that an updated guideline for management of the balance of equity
8 compared to fixed-income investment could serve to establish greater clarity about the parameters
9 of authorized management of the balance of the invested funds.

10 21. Traditionally, equity investments carry a greater risk than fixed-income
11 investments. Equity investors expect greater returns as compensation for the additional risk
12 associated with an equity investment when compared to a fixed-income investment. In the recent
13 past, the stock market has experienced a great deal of volatility, particularly downward volatility.
14 While no one can know the future of securities markets, a risk-averse management strategy for the
15 decommissioning funds is likely to be prudent given the importance of nuclear decommissioning
16 and need for the availability of funding for the nuclear decommissioning. As time passes and the
17 date when decommissioning of the Palo Verde Nuclear Generating Station draws closer, a
18 management strategy of the decommissioning funds that steadily reduces risk further will be
19 progressively more prudent. As the decommissioning date draws close, a balance of funds within
20 the decommissioning portfolio that minimizes equity funds in favor of less risky investments will
21 likely be appropriate.

22 22. An order specifying that APS is authorized to move funds between the equity and
23 fixed-income investments so long as the overall equity investment percentage of the investment
24 portfolio does not exceed 60 percent will serve to both grant APS the flexibility to prudently
25 manage the decommissioning funds as appropriate for the prevailing market conditions and adjust
26 the balance between funds within the portfolio as the decommissioning date approaches. Such an
27 order will also serve to provide greater clarity regarding the approved management of the
28 decommissioning fund's balance of equity and fixed-income investment.

1 23. In addition to providing a periodic opportunity for the Commission to manage the
2 fund levels of each of the three funds, the caps have served in the past as a mechanism that has
3 brought the matter of the general management of the fund to the attention of the Commission
4 periodically and prompted the issue at Open Meeting for the Commission to make adjustments to
5 the management of the funds whether the adjustments dealt with the fund levels or any other
6 aspect of fund management.

7 24. Removal of the caps would provide APS with greater flexibility to manage the fund
8 portfolio; however, it will eliminate the impetus for APS to periodically raise the issue for the
9 Commission's consideration, as well as a convenient opportunity for the Commission to review the
10 status of the portfolio and, should it choose to do so, issue any new orders to adjust the portfolio as
11 deemed appropriate.

12 25. APS does file an annual Decommissioning Fund Performance Report with the
13 Director of the Utilities Division pursuant to Decision No. 56047 (July 1988). The reports,
14 however, do not involve an Open Meeting forum for Commission consideration as do applications
15 for changes to the fund caps.

16 26. Staff has recommended removal of the funding contribution caps for each of the
17 Palo Verde Nuclear Generating Station decommissioning trust funds in order to provide flexibility
18 that will enable APS to best manage fund risk in the decommissioning portfolio.

19 27. Staff has further recommended authorization for APS to move funds between the
20 equity and fixed-income investments so long as the overall equity investment percentage of the
21 investment portfolio does not exceed 60 percent in order to provide flexibility that will enable APS
22 to best manage fund risk in the decommissioning portfolio.

23 28. Staff has further recommended that, every five years, APS make informational
24 filings with the Commission through Docket Control. The informational filings shall be in a
25 written format including the information contained in the annual Decommissioning Fund
26 Performance Reports and also include descriptive discussion of the performance of the funds and
27 other information APS deems would be helpful to the Commission in its oversight of the funds.

28 ...

29. These informational filings shall be filed promptly following receipt of the annual fund performance reports APS receives from the trustee. These informational filings and the related Open Meeting presentations described below shall occur in five year increments and correspond with every subsequent fifth annual Decommissioning Fund Performance Report filed with the Utilities Division Director beginning in 2011.

30. Following the filing of each fifth year filing containing the information described in Finding of Fact No. 28 above, APS shall provide an oral presentation in Open Meeting relating to the written informational filing. Staff makes this recommendation to create the same Open Meeting forum for Commission consideration as has previously been afforded by applications for changes to the fund caps. Staff notes that the Commission would be able to take any appropriate action at that time.

CONCLUSIONS OF LAW

1. Arizona Public Service Company is a public service corporation within the meaning of Article XV of the Arizona Constitution.

2. The Commission has jurisdiction over Arizona Public Service Company and the subject matter of the application.

3. The Commission, having reviewed the application and Staff's Memorandum dated May 11, 2010, concludes that it is in the public interest to remove the funding contribution caps for each of the Palo Verde Nuclear Generating Station decommissioning trust funds; and authorize APS to move funds between the equity and fixed-income investments so long as the overall equity investment percentage of the investment portfolio does not exceed 60 percent.

ORDER

IT IS THEREFORE ORDERED that the funding contribution caps for each of the Palo Verde Nuclear Generating Station decommissioning trust funds are hereby removed.

IT IS FURTHER ORDERED that Arizona Public Service Company is authorized to move funds between the equity and fixed-income investments so long as the overall equity investment percentage of the investment portfolio does not exceed 60 percent.

...

1 IT IS FURTHER ORDERED that Arizona Public Service Company make informational
2 filings with the Commission through Docket Control and present such information to the
3 Commission in Open Meeting as discussed in Finding of Fact No. 28.

4 IT IS FURTHER ORDERED that this Decision shall become effective immediately.
5

6 **BY THE ORDER OF THE ARIZONA CORPORATION COMMISSION**
7

8
9 CHAIRMAN

COMMISSIONER

10
11 COMMISSIONER

COMMISSIONER

COMMISSIONER

12
13 IN WITNESS WHEREOF, I, ERNEST G. JOHNSON,
14 Executive Director of the Arizona Corporation Commission,
15 have hereunto, set my hand and caused the official seal of
16 this Commission to be affixed at the Capitol, in the City of
17 Phoenix, this _____ day of _____, 2010.

18 _____
19 ERNEST G. JOHNSON
EXECUTIVE DIRECTOR

20 DISSENT: _____
21

22 DISSENT: _____
23

SMO:SPI:lhv\CH
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1 SERVICE LIST FOR: Arizona Public Service Company
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